Financial Statements

Year Ended September 30, 2004

Michigan Deptartment of Treasury 496 (2-04) Auditing Procedures Report

Issued under P.A. 2 of Local Government Ty	1968, a				Local Governme	ent Name		Cou	nty	
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Audit Date 9/30/04			Opinion [12/23/			Date Accountant Repor	t Submitted to State:			
accordance with	the S	Statem	ents of	the Govern	mental Accou	nting Standards B	ndered an opinion o oard (GASB) and t e Michigan Departm	the <i>Unifor</i> i	n Rep	
We affirm that:										
We have com	ıplied	with th	ie <i>Bulleti</i>	in for the Au	idits of Local U	Inits of Government	<i>t in Michigan</i> as revis	sed.		
2. We are certifi	ed pu	blic ac	countant	ts registered	to practice in	Michigan.				
We further affirm comments and re		-		responses h	ave been disc	losed in the financia	al statements, includ	ing the not	es, or i	n the report of
You must check th	ie app	olicable	box for	each item b	elow.					
Yes V No	, 1 .	Certa	in comp	onent units/	funds/agencie	s of the local unit ar	re excluded from the	financial	stateme	ents.
Yes No	2.		e are aco of 1980).		deficits in one	or more of this un	it's unreserved fund	l balances/	retaine	d earnings (P.A
Yes 🕢 No	3.		e are ins	stances of i	non-complianc	e with the Uniform	Accounting and B	udgeting A	kct (P.A	A. 2 of 1968, as
Yes ✓ No	4.					tions of either an o the Emergency Mu	order issued under nicipal Loan Act.	the Munic	ipal Fi	nance Act or its
Yes ✓ No	5.					nts which do not c of 1982, as amende	comply with statutory d [MCL 38.1132]).	y requirem	ents. (I	P.A. 20 of 1943
☐ Yes 🗸 No	6.	The k	ocal unit	has been d	elinquent in di	stributing tax revenu	ues that were collect	ted for ano	her ta	xing unit.
∐Yes 🗸 No	7.	pensi	ion bene	fits (normal	costs) in the	current year. If the	t (Article 9, Section plan is more than tributions are due (pa	100% fund	ed and	the overfunding
Yes 🗸 No	8.		local uni . 129.241		lit cards and h	has not adopted ar	n applicable policy	as require	d by P	.A. 266 of 1995
Yes 🗸 No	9.	The lo	ocal unit	has not add	opted an invest	tment policy as requ	uired by P.A. 196 of	1997 (MCL	. 129.9	5).
We have enclose	ed the	follov	wing:				Enclosed	To E Forwa		Not Required
The letter of com	nents	and re	ecomme	ndations.			1			,
Reports on individ	lual fe	deral f	financial	assistance	programs (pro	gram audits).				✓
Single Audit Repo	orts (A	SLGU).				✓			
Certified Public Accou			ne)							
Street Address 211 E. Water S			te 300		Mar. 474 (1974) 1974 1974 1974 1974 1974 1974 1974 1974	City Kalama	ızoo	State MI	ZIP 49 (007
Accountant Signature	H	11	1	Dam	- 0 نیر			Date 3-	7-0	5

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Independent Auditors' Report

Board of Directors Community Mental Health Authority of Clinton, Eaton, and Ingham Counties Lansing, Michigan

We have audited the accompanying financial statements of the governmental activities, the major fund, and the aggregate remaining fund information of the Community Mental Health Authority of Clinton, Eaton, and Ingham Counties (the Authority), as of and for the year ended September 30, 2004, which collectively comprise the Authority's basic financial statements, as listed in the accompanying table of contents. These financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the major fund, and the aggregate remaining fund information of the Authority, as of September 30, 2004, and the changes in financial position and cash flows, where applicable, thereof and the budgetary comparison for the General Fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated December 23, 2004, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit preformed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's discussion and analysis on Pages 3 through 8 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The Combining and Individual Fund Statements and Schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

BDO Sudan, LLA

Certified Public Accountants

MANAGEMENT DISCUSSION AND ANALYSIS

As management and administrators of the Community Mental Health Authority of Clinton, Eaton, and Ingham Counties (the Authority), we offer readers of the Authority's financial statements this background information on our funding and analysis of the financial activities of the Authority for the fiscal year ended September 30, 2004.

Funding Background

The Fiscal Control and Restraint of Constricted Public Funding

The Authority is one of the pre-eminent human service providers in the greater Lansing area and one of the innovative community mental health authorities in the state. Over the last several years, the Authority has made a number of cost cutting changes and innovative revenue enhancements in order to balance its budget in the face of the following:

- Years without a funding increase from the state of Michigan or with very modest cost of living increases (far less than CPI or Health Care CPI). Given that state funding, in the form of state general fund and Medicaid dollars, consists of 80% of the Authority's budget, stagnant funding from the state has a disastrous impact on the Authority's budget.
- Increased costs in a number of areas, which are typical of those experienced by employers throughout the country.

These cuts, taken over these last five years, have totaled approximately \$15 million (\$600,000 in fiscal year 2000, \$1.7 million in fiscal year 2001, \$4.6 million in fiscal year 2002, \$3.1 million in fiscal year 2003, and \$4.8 million in fiscal year 2004) representing 21% of the Authority's annual budget and could have been avoided, in their entirety, through the provision of modest cost-of-living increases of 4% annually over those years. The modest size of these cost increases are in sharp contrast to the increases experienced by other health care providers and health care insurers during the same period--increases ranging from 4.3% to 12.6%.

The Causes of Structural Deficits

In 1998, the Authority went from the fee-for-service system to a capitated arrangement (when the Authority became the care manager for the mental health benefit for Medicaid enrollees in the three county region). In such an arrangement, the Authority receives a payment for each Medicaid recipient living in the area covered by the Authority (thus, a "per capita" or capitated arrangement). This payment is actually a mental health care insurance premium and is designed to cover the cost of providing mental health care to those Medicaid recipients in need of such care. A similar arrangement, using a different formula, provides funding to the Authority to serve the non-Medicaid residents in the community. Under this arrangement, our revenue does not change when we serve more individuals or provide more care. It changes only when the number of Medicaid enrollees in the tri-county area changes.

This capitated arrangement, allowed by the federal government under a Medicaid waiver (1915b), stipulated that one of the aims of the system was to ensure that the cost of the system was marked by slow growth of 4% to 5% per year.

In the first year of the capitated system (fiscal year 1999) the Authority received a 2.7% increase in its capitation rates. Since that time, however, for five consecutive years, the rates have not increased, leaving the Authority with a revenue growth rate of 0.5% per year over these five years. This is in stark contrast to both the slow revenue growth goal of the waiver, 4 % to 5 % per annum, and all recognized measures of health care price increases during the period, which show health care cost increases ranging from 4.3 % to 12.6 % per year.

There are several measures of health care cost changes, against which the increases to the Michigan Community Mental Health system may be compared:

		Percent
A.	1998-1999 Health Services Producer Index (U.S.)	4.30
B.	1998-1999 Consumer Price Index for Medical Care Services, all urban consumers (U.S.)	8.73
C.	1998-1999 Consumer Price Index for Medical Care Services, Detroit-Ann Arbor, Flint	12.65

Prior to this switch to a capitated system, for nearly two decades, from the early 1980's through 1998, the community mental health system in Michigan received an ever growing share of its funding via the federal Medicaid system on a fee-for-service basis. Such an arrangement allowed the revenue to community mental health systems to grow dramatically in two ways:

- Billing Medicaid for services allowed us to receive new federal Medicaid dollars by serving Medicaid recipients. We received approximately one federal dollar for every state dollar spent serving a Medicaid recipient. It is important to note that state funding, during an 18year period, was not increased. The state funds used to match the federal dollars were those state funds already in our budget.
- The fee-for-service structure allowed us (and providers paid under a fee-for-service system) to receive additional funds if we provided more services.

Critical to understanding of this funding arrangement is the fact that this ability to draw down federal dollars and the fact the Authority assumed an increasing number of mental health responsibilities formerly held by the state (community placement of individuals formerly living in state hospitals, AIS homes, utilization management of and payment for local hospital care) were the only sources of revenue growth for the Authority over the last several decades. No new state dollars were added to the Authority over the past two decades.

The Aggressive, Proactive, and Responsive Actions to Counter Impact Constricted Revenue

The Authority has not been a passive observer to these budget cuts nor to the events that led to them. The Authority has:

- Actively engaged in legislative efforts, as part of the Michigan Association of Community Mental Health Boards, the Mental Health Coalition, and acting on its own to prevent the appropriations decisions that led to these cuts.
- Prepared, well in advance, for a range of funding scenarios, including the scenario leading to the projected deficit.
- Taken aggressive steps over the past several years to reduce costs via increases in staff
 efficiency and the utilization of the flexibility granted the Authority under the Medicaid
 managed care waiver. These steps worked to minimize, as much as possible, the negative
 impact of the proposed cuts on consumers.
- Built alliances with community partners to stretch limited resources.
- Continued to aggressively seek additional funding for a wide range of innovative services to
 the tri-county community, including federal, state, local, commercial, and private sources.
 These efforts have resulted in innovative services for which funding was obtained from the
 U.S. Department of Housing and Urban Development, U.S. Department of Health and Human
 Services, Michigan Department of Corrections, and a number of local school districts.
 Additionally unique financing approaches, by which the limited resources of a number of
 partners are used to leverage additional revenue.

The Integrity of its Clinical, Fiscal, and Organizational Infrastructure

We see the cuts taken this year and in past years as representative of society's and the state's retreat in their commitment to the disabled, at-risk, and marginalized members of our communities. In spite of this, the Authority remains strong at its core. The Authority has been committed, in the face of budget cuts, to remaining clinically, organizationally, and fiscally strong while ensuring its infrastructure was not permanently damaged by the cuts. The following give us a picture of that strength.

- A. We have been committed to and successful in making budget cuts avoiding, whenever possible, harming consumers.
- B. We have been committed to doing a smaller number of things well rather than doing a large number of things poorly.
- C. Even after the cuts, we are still a very strong human service provider in this community, with a budget of \$67 million, a staff of 800 individuals, serving over 10,000 individuals each year. Our stature among other human service organizations is very strong and getting stronger.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's financial statements. The Authority's financial statements comprise three components:

- 1. Government-wide financial statements
- 2. Fund financial statements
- 3. Notes to the financial statements

This report also contains other supplementary information in addition to the financial statements themselves.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide readers with a broad overview of the Authority's finances in a manner similar to a private-sector business. This is accomplished by reporting the Authority's assets and liabilities using the full accrual method of accounting. Prior to the implementation and adoption of GASB No. 34, the assets and liabilities of the Authority were reported using the modified accrual method of accounting. In essence, this change in accounting method requires the Authority to disclose borrowings, compensated absences for employees, and capital assets less accumulated depreciation on the Authority's financial statements.

The Statement of Net Assets presents information on all the Authority's assets and liabilities with the difference between the two reported as total net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The Statement of Activities presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods. In addition, this statement discloses the non-cash expenditure of depreciation that affects the ending book value of capital assets.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources segregated for specific activities or object. The Authority, similar to state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Authority may be divided into three categories: Governmental Funds, Internal Service Funds, and Fiduciary Funds.

Governmental Funds

Governmental Funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, a well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirement.

Because the focus of Governmental Funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for Governmental Funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between Governmental Funds and governmental activities.

The Authority adopts an annual budget for its General Fund. Budgetary comparison statements have been provided for the General Fund to demonstrate compliance with those budgets.

Proprietary Funds - Internal Service Funds

Proprietary Funds are used to account for the Authority's business-type activities. The Risk Reserve Funds are used to account for assets held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH). Pursuant to these contractual provisions, the Authority's risk management plan has been reviewed and approved by MDCH. Separate risk reserves are maintained for mental health and substance abuse services. The Fixed Asset Replacement Reserve is used to account for and finance future fixed asset purchases and the Compensated Absences Reserve is used to account for the Authority's vacation benefit liability. Both the Fixed Asset Replacement Reserve and the Compensated Absences Reserve are permitted by the Michigan Mental Health Code.

Fiduciary Funds

Fiduciary Funds are used to account for resources held for the benefit of parties outside the government. Fiduciary Funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Authority's own programs. Fiduciary Funds are commonly referred to as payee funds. The accounting used for Fiduciary Funds is much like that used for Proprietary Funds.

Notes to Financial Statements

The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The accompanying notes are an integral part of the financial statements and must be reviewed in conjunction with the information reported on the financial statements to provide a full understanding of the Authority's financial situation.

Other Information

The combining statements are presented immediately following the notes to the financial statements.

Government-Wide Financial Analysis

By far the largest portion of the Authority's total assets (53%) reflects its investment in capital assets (e.g., land, buildings, vehicles, and equipment). The Authority uses these capital assets to provide services to the clients it serves; consequently, these assets are not available for future spending and are considered fixed. Although the Authority's investment in its capital assets is reported net of related debt, it should be noted that the resource needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The corresponding debt for the facilities makes up the largest portion of the Authority's liabilities representing approximately 47%.

Net Assets

	Governmental Activities				
September 30,		2004		2003	
Current and other assets	\$	12,435,612	\$	10,450,584	
Investments		5,791,374		4,388,832	
Capital assets, net		16,216,364		16,571,456	
Total Assets		34,443,350		31,410,872	
Long-term liabilities outstanding		9,629,389	_	10,548,074	
Other liabilities		14,702,571		11,501,477	
Total Liabilities		24,331,960		22,049,551	
Net Assets:					
Invested in capital assets, net of related debt		6,048,344		6,105,812	
Restricted		2,662,478		1,923,246	
Unrestricted		1,400,568		1,332,163	
Total Net Assets	\$	10,111,390	\$	9,361,221	

Changes in Net Assets

G	Governmental Activities				
Year Ended September 30,		2004	2003		
Revenues:					
Program revenue:					
Charges for services	\$	753,932	\$	697,779	
Operating grants and contributions		40,851,442	37,	677,114	
General revenue:					
MDCH contract		55,171,697	55,	982,658	
Risk reserve funds received from affiliates		-		626,970	
Local Funding		2,365,054	2,	310,773	
Unrestricted investment earnings		101,877		107,508	
Gain on sale of capital assets		-		418,832	
Total Revenues		99,244,002	97,	821,634	
Expenses:					
Adults with mental illness		19,611,977	20,	716,953	
Children with emotional disturbance		6,226,819	6,	121,595	
Developmental disabilities		31,313,377	30,	241,125	
Substance abuse		2,781,016	2,	463,014	
Board administration		5,885,845	6,	255,838	
Medicaid pass-through		31,630,522	30,	632,888	
Affiliation		532,606	:	322,015	
Interest		511,771	4	474,185	
Total Expenses		98,493,933	97,2	227,613	
Change in Net Assets		750,069		594,021	
Net Assets, beginning of year		9,361,321	8,7	767,300	
Net Assets, end of year	\$	10,111,390	\$ 9,3	361,321	

Financial Analysis of the Government's Funds

As noted earlier, the Authority uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The focus of the Authority's Governmental Funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Authority's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Authority's Governmental Funds reported an ending fund balance of \$2,049,618, an increase of \$408,931 in comparison with the prior year. Approximately 44.6% of this total amount (\$914,460) constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved or restricted to indicate it is not available for new spending because the underlying assets are included in inventory and prepaids and are not available for current expenditures or are restricted and must be used for the ongoing construction project.

Capital Assets and Debt Administration

Capital Assets

The Authority's investment in capital assets for its governmental activities as of September 30, 2004, amounted to \$16,216,364 (net of accumulated depreciation of \$12,308,253). This investment in capital assets includes land, buildings, vehicles, and equipment. Additional information on the Authority's capital assets can be found in Footnote 6 of the financial statements.

Debt Administration

The Authority's long-term debt activity consisted of adding an additional \$679,137 of installment debt and making debt service payments therefore decreasing debt by \$933,105. Additional information on the Authority's long-term obligations can be found in Footnote 7 of the financial statements.

Budget Modifications

There were three primary budget modifications in fiscal year 2004 impacting both revenues and expenses:

- The MDCH reduced the amount of General Funds paid to the Authority by \$2,258,000.
- The MDCH increased the amount of Medicaid paid to the Authority by \$1,786,000 for CEI and \$723,000 for our affiliates.
- The MDCH provided new Earned Contract funding to the Authority titled Adult Benefit Waiver of \$1,733,000.

Variance Budget to Actual

There were two predominant variances between budget and actual:

- The total Medicaid received for the Authority and its affiliates was \$500,000 greater than the amount budgeted.
- The allocation of Medicaid between the Authority and its affiliates was adjusted at year-end to reflect the actual amount expended. This resulted in an increase in revenue of \$1,891,000 for the Authority, and a decrease in Medicaid of \$1,382,000 for its affiliates.

Contacting the Authority's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the funds received. If you have questions about this report or need additional information, contact the Business Office, Community Mental Health Authority of Clinton, Eaton, and Ingham Counties, 812 East Jolly Road, Suite 210, Lansing, Michigan 48910.

Government-Wide Financial Statements Statement of Net Assets

	Governmen		
September 30, 2004		Activities	
Assets:			
Cash and cash equivalents (Note 4)	\$	6,018,921	
Investments (Note 4)		5,791,374	
Accounts receivable, net (Note 5)		5,281,533	
Prepaids and other assets		868,443	
Restricted cash (Note 4)		266,715	
Capital assets not depreciated (Note 6)		1,428,250	
Capital assets depreciated, net (Note 6)		14,788,114	
Total Assets	\$	34,443,350	
Liabilities: Accounts payable and accrued liabilities Deferred revenue (Note 5) Current portion of long term liabilities (Note 7) Noncurrent portion of long term liabilities: Compensated absences (Notes 7 and 8)	\$	8,175,577 4,213,747 2,313,247 382,335	
Debt and capital lease obligations (Note 7)		9,247,054	
Total Liabilities		24,331,960	
Net Assets:			
Invested in capital assets, net of related debt		6,048,344	
Restricted for:			
Contract losses		2,395,763	
Other purposes		266,715	
Unrestricted		1,400,568	
Total Net Assets		10,111,390	
Total Liabilities and Net Assets	\$	34,443,350	

Government-Wide Financial Statements Statement of Activities

			Progra	am Revenues	Governmental Activities
Year ended September 30, 2004	Expenses	Charges for Services		Operating Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets (Deficit)
Functions/Programs:					
Governmental activities:					
Adults with mental illness	\$ 19,611,977	\$	449,499	\$ 2,248,147	£ (16.014.221)
Children with emotional disturbance	6,226,819	Ψ	96,093	1,526,599	\$ (16,914,331)
Developmental disabilities	31,313,377		92,552	2,513,847	(4,604,127) (28,706,978)
Substance abuse	2,781,016		115,584	1,935,203	(730,229)
Board administration	5,885,845		204	372,091	(5,513,550)
Affiliation	532,606			591,069	58,463
Medicaid pass-through	31,630,522		_	31,664,486	33,964
Interest	511,771			-	(511,771)
Total Governmental Activities	\$ 98,493,933	\$	753,932	\$ 40,851,442	(56,888,559)
	General Reven	ues:			
	MDCH Contr	act:			
	Medicaid				43,187,761
	General Fu	nd			11,983,936
	Local Funding	g			2,365,054
	Unrestricted in	nvestr	nent earning	<u>s</u>	101,877
	Total General I	Reven	ues		57,638,628
	Increase in Net	Asset	s		750,069
	Net Assets, begin	nning	of year		9,361,321
	Net Assets, end	of yea	r		\$ 10,111,390

Governmental Funds Balance Sheet

G I 20 2004	Con and Free		
September 30, 2004	General Fun		
Assets:			
Cash and cash equivalents (Note 4)	\$	4,245,946	
Investments (Note 4)		4,108,238	
Accounts receivable (Note 5):			
Grants and contracts		1,878,165	
Affiliate		1,980,988	
Fees		847,604	
Trade		101,636	
Other receivable		472,700	
Inventories		144,113	
Prepaid expenditures and deposits		724,330	
Restricted cash (Note 4)		266,715	
Total Assets	\$	14,770,435	
Liabilities and Fund Balance			
Liabilities:			
Accounts payable:			
State of Michigan	\$	1,949,467	
Community inpatient hospitalization		1,140,081	
Trade		2,777,455	
Other		734,661	
Accrued payroll		1,573,913	
Internal balances (Note 9)		331,493	
Deferred revenue (Note 5)		4,213,747	
Total Liabilities		12,720,817	
Fund Balance:			
Reserved:			
Major maintenance		266,715	
Inventories		144,113	
Prepaids		724,330	
Unreserved -		-	
Undesignated		914,460	
Total Fund Balance		2,049,618	
Total Liabilities and Fund Balance	\$	14,770,435	

Governmental Funds

Reconciliation of Fund Balance of Governmental Fund to the Net Assets of Governmental Activities on the Statement of Net Assets

September 30, 2004

Total fund balance - governmental fund (from Page 11)

\$ 2,049,618

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Internal Service Funds are used by management to set aside certain resources as a risk reserve against potential contract losses in future periods for fixed asset replacement and to fund compensated absences. The assets and liabilities of the Internal Service Funds are included in governmental activities in the Statement of Net Assets.

Add - Net assets of Internal Service Funds

8,061,772

Net Assets of Governmental Activities

\$ 10,111,390

Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balance

Year ended September 30, 2004	General Fund
Revenues:	
Federal sources	\$ 1,673,324
State sources	12,268,729
Local sources	3,231,892
Medicaid contracts	44,726,760
Other contracts	4,823,005
Charges for services and fees	753,932
Investment income	78,360
Medicaid pass-through	31,664,486
Total Revenues	99,220,488
Expenditures:	
Adults with mental illness	19,910,435
Children with emotional disturbance	6,338,798
Developmental disabilities	31,540,599
Substance abuse	2,852,984
Board administration	6,002,781
Affiliation	535,438
Medicaid pass-through	31,630,522
Fotal Expenditures	98,811,557
ncrease in Fund Balance	408,931
Fund Balance, beginning of year, as restated (Note 12)	1,640,687
Fund Balance, end of year	\$ 2,049,618

Governmental Funds

Reconciliation of Statement of Revenues, Expenditures, and Changes in Fund Balance of the Governmental Fund to Statement of Activities

let change in fund balance - governmental fund (from Page 13)	\$	408,931
Internal Service Funds are used by management to set aside certain resources		
as a risk reserve against potential contract losses in future periods for fixed		
asset replacement and to fund compensated absences. The net revenue		
(expense) of those funds are reported with governmental activities:		
Add - Net operating income from Internal Service Funds		753,689
Add - Interest revenue from Internal Service Funds		23,517
Deduct - Interest expense from Internal Service Funds		(511,771
Some expenses reported in the Statement of Activities do not require the use of		
current financial resources and, therefore, are not reported as expenditures in		
the funds.		
Add - Decrease in the accrual for the estimated insurance liability		75,703
hange in Net Assets of Governmental Activities	¢	750,069

Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual General Fund

Year ended September 30, 2004	Budget	Final Budget	Actual	Final Budget Positive (Negative)
Revenues:				
Federal grants and contracts	\$ 1,688,991	\$ 1,701,460	\$1,673,324	\$ (28,136)
State of Michigan	15,099,379	12,882,435	12,268,729	(613,706)
Local revenue	3,774,790	3,424,517	3,231,892	(192,625)
Earned contracts	2,543,665	4,382,688	3,842,621	(540,067)
Medicaid:				
PIHP	39,526,805	41,296,764	43,187,761	1,890,997
Substance abuse - PIHP	184,290	167,510	207,406	39,896
Fee for service	1,849,401	1,475,112	1,331,593	(143,519)
Pass-through	32,275,234	32,998,181	31,664,486	(1,333,695)
SSI/SSA	892,119	948,220	980,384	32,164
Fees	638,436	548,522	586,098	37,576
Food stamps	136,503	165,638	167,834	2,196
Interest	80,000	80,000	78,360	(1,640)
Total Revenues	98,689,613	100,071,047	99,220,488	(850,559)
Expenditures:				
Adults with mental illness	19,205,973	19,796,456	19,910,435	(113,979)
Children with emotional disturbance	6,671,290	6,325,472	6,338,798	(13,326)
Adults with developmental disabilities	31,068,936	31,710,251	31,540,599	169,652
Substance abuse	2,779,170	2,804,197	2,852,984	(48,787)
Board administration	6,145,474	6,055,091	6,002,781	52,310
Affiliation administration	543,536	542,859	535,438	7,421
Medicaid pass-through	32,275,234	32,998,181	31,630,522	1,367,659
Total Expenditures	98,689,613	100,232,507	98,811,557	1,420,950
Change in Fund Balance	-	(161,460)	408,931	570,391
Fund Balance, beginning of year, as restated (Note 12)	1,640,687	1,640,687	1,640,687	-
Fund Balance, end of year	\$ 1,640,687	\$ 1,479,227	\$2,049,618	\$ 570,391

Statement of Net Assets Proprietary Funds

September 30, 2004		Internal Service Funds
Assets:		
Cash and cash equivalents (Note 4)	\$	1,772,975
Investments (Note 4)	•	1,683,136
Internal balances (Note 9)		331,493
Interest receivable		440
Capital assets not being depreciated (Note 6)		1,428,250
Capital assets being depreciated, net (Note 6)		14,788,114
Total Assets	\$	20,004,408
Liabilities: Current portion of long term liabilities (Note 7) Long-term liabilities:	\$	2,313,247
Compensated absences payable (Notes 7 and 8)		382,335
Debt and capital lease obligations (Note 7)		9,247,054
Total Liabilities		11,942,636
Net Assets:		
Invested in capital assets, net of related debt		6,048,344
Unrestricted		2,013,428
Total Net Assets		8,061,772
Total Liabilities and Net Assets	s	20,004,408

Statement of Revenue, Expenses, and Changes in Fund Net Assets Proprietary Funds

Year ended September 30, 2004		Internal Service Funds
		· · · · · · · · · · · · · · · · · · ·
Operating Revenue -		
Charges for services	\$	1,822,264
Operating Expenses:		
Program services		214
Depreciation		1,068,361
Total Operating Expenses		1,068,575
Operating Income		753,689
Non-Operating Revenue (Expense):		
Interest income		23,517
Interest expense		(511,771)
Total Non-Operating Expense		(488,254)
Change in Net Assets		265,435
Net Assets, beginning of year, as restated (Note 12)		7,796,337
Net Assets, end of year	s	8,061,772

Statement of Cash Flows Proprietary Funds

Year ended September 30,		2004
Operating Activities:		
Payments received from other funds	\$	1,819,871
Payments to outside parties		(30,015)
Cash Provided by Operating Activities	· · · · · · · · · · · · · · · · · · ·	1,789,856
Capital and Related Financing Activities:		
Proceeds from new installment debt		679,137
Principal payments		(933,105)
Interest payments		(511,771)
Capital asset purchases		(713,269)
Cash Used in Capital and Related Financing Activities		(1,479,008)
Investing Activities:		
Interest income		23,422
Purchase of investments		(348,710)
Cash Used in Investing Activities		(325,288)
Decrease in Cash		(14,440)
Cash and Cash Equivalents, beginning of year		1,787,415
Cash and Cash Equivalents, end of year	\$	1,772,975
Reconciliation of Operating Loss to		
Net Cash Provided by Operating Activities:		
Operating income	S	753,689
Adjustments to reconcile operating income to	.	755,007
net cash provided by operating activities:		
Depreciation		1,068,361
Changes in assets and liabilities:		1,000,001
Internal balances		(2,393)
Accounts payable - other		(29,951)
Compensated absences payable		150
Net Cash Provided by Operating Activities	\$	1,789,856

Statement of Fiduciary Net Assets Fiduciary Funds

September 30, 2004	Private Purpose Trust Fund			Agency Fund	
Assets:					
Cash and cash equivalents Note 4) Investments (Note 4)	\$	16,882	\$	381,133	
Total Assets	\$	16,882	\$	381,133	
Liabilities and Net Assets					
Liabilities -					
Accounts payable	\$	-		381,133	
Net Assets -					
Held in trust		16,882			
Total Liabilities and Net Assets	\$	16,882	\$	381,133	

Statement of Changes in Fiduciary Net Assets Fiduciary Funds

Year ended September 30, 2004	Private Purpose Trust Fund
Additions -	
Investment earnings	\$ 4
Deductions -	
Program services	385
Change in Net Assets	(338
Net Assets, beginning of year	17,220
Net Assets, end of year	\$ 16,882

Notes to Financial Statements

1. Description of the Authority

The Community Mental Health Authority of Clinton, Eaton, and Ingham Counties (the Authority) was established under Section 205 of the Michigan Mental Health Code.

The Authority provides services generally in the areas of mental health, comprehensive substance abuse treatment, and developmental disabilities for the Clinton, Eaton, and Ingham County region. The Authority's activities are funded through federal grants, state allocations, premium revenue, county appropriations, service fees, and local gifts and grants.

2. Summary of Significant Accounting Policies

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority's significant accounting policies are described below.

Basis of Presentation

Government-wide financial statements: The Statement of Net Assets and the Statement of Activities report information on all of the activities of the Authority. For the most part, the effect of inter-fund activity has been removed from these statements. The Government-wide financial statements categorize activities as either governmental or business-type. All of the Authority's activities are classified as governmental.

The Statement of Activities demonstrates the degree to which the direct expenses related to a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include (1) charges to recipients who purchase, use or directly benefit from goods, services or privileges provided by a given function and (2) grants and contributions that are restricted to meeting the operation or capital requirements of a particular function. Other items not included among program revenues are reported as general revenues.

Separate financial statements are provided for Governmental Funds, Proprietary Funds, and Fiduciary Funds. The General Fund is the only governmental fund in the fund financial statements.

Measurement Focus and Basis of Accounting

Government-Wide Financial Statements - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Notes to Financial Statements (Continued)

Fund Financial Statements - Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered available if they are collected within the current period or soon enough after to pay liabilities for the current period. The Authority considers revenues available if collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures as well as expenditures related to compensated absences, are recorded only when payment is due.

Service charges to first and third-party payor and grant funds associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period.

The Authority reports the following major governmental fund -

• The General Fund is the general operating fund of the Authority. It is used to account for all financial resources except those required to be accounted for in another fund.

Additionally, the Authority reports the following fund types:

- The Internal Service Funds are used to account for and finance potential uninsured risks of loss related to various funds received through the Michigan Department of Community Health (MDCH), as well as for reserves for fixed asset replacement and compensated absences, as permitted by the Michigan Mental Health Code.
- The Fiduciary Funds are used to account for resources held for the benefit of parties outside the government.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the government's internal service fund are charges to other funds for services provided. All revenues and expenses not meeting this definition are reported as non-operating revenues.

Notes to Financial Statements (Continued)

Assets, Liabilities, and Net Assets

Cash and Investments - Cash and investments include cash on hand, demand deposits, and short-term investments with a maturity of three months or less. Investments are stated at fair value. Investments are recorded at fair value, based on quoted market prices.

Inventories, Prepaids, and Deposits – Inventories are valued at the lower of cost or market on a first-in, first-out basis, which approximates market. Inventories consist of materials for the toothbrush production facility at Bretton Square.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items. Certain funds held by third parties for future benefits are recorded as deposits. Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as internal balances.

Capital Assets - Capital assets are capitalized and reported in the Fixed Asset Replacement Reserve Internal Service Fund, net of accumulated depreciation. Capital assets are depreciated on the straight-line basis over the estimated useful lives of those assets, which range from five to forty years. All purchased fixed assets are recorded at cost where historical records are available and at estimated historical costs where no historical records exist. Donated fixed assets, if any, are valued at their estimated fair market value on the date received.

Only improvements that add to the value of the asset or materially extend assets useful lives are capitalized. It is the policy of the Authority to capitalize assets whose value exceeds \$5,000.

Compensated Absences – Compensated absences are charged to operations in the Compensated Absences Reserve Internal Service Fund when earned by employees.

Risk Management – The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; etrors and omissions; and injuries to employees. The Authority manages its risk exposures and provides certain employee benefits through a combination of self-insurance programs, risk management pools and commercial insurance and excess coverage policies. On risks that are commercially insured, settlements have not exceeded insurance coverage in any of the past three years. In addition to these coverages, the Authority has established two Internal Service Funds to cover any potential operating shortfalls under the terms of its contract with MDCH.

MDCH Revenue – The Authority provides mental health services on behalf of the MDCH in accordance with a managed specialty supports and services contract. Under the contract, the Authority receives monthly capitation payments based on the number of the MDCH's participants, regardless of services actually performed by the Authority. In addition, the MDCH makes fee-for-service payments to the Authority for certain covered services.

Notes to Financial Statements (Continued)

Deferred Revenue – Deferred revenue represents the portion of the current year MDCH contract amount and other grant revenues that may be carried over to and expended in subsequent fiscal years. Such carryover is generally limited to 5% of the MDCH contract amount.

Medicaid savings are considered local funds under the contract with MDCH and may be spent over a period of several years in accordance with a Medicaid Reinvestment Strategy. State general funds carried over must generally be spent in the following year.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

CMH Affiliation of Mid-Michigan – In 2003, the Michigan Department of Community Health changed the requirements for administering Medicaid contracts. As part of this change, smaller CMH boards were required to partner together to create affiliations of sufficient size to be able to contract with MDCH. The Authority acts as the hub for one such affiliation. Accordingly, a substantial portion of the Authority's budget is reported as "affiliation expense," and is passed-through to the CMH boards of other counties, subject to an affiliation agreement.

3. Stewardship, Compliance, and Accountability

Budgetary Information – The annual budget is prepared by the executive director in August of each year and adopted by the Authority during September. The budget reports revenue related to substance abuse separately from the other revenue categories, as reported on the Statement of Revenue, Expenditures, and Changes in Fund Balance – General Fund. The budget reports expenditures by activity versus object classification. Subsequent amendments are approved by the Authority.

Excess of Expenditures Over Appropriations – The budget has been adopted on a program basis; expenditures at this level in excess of amounts budgeted are a violation of Michigan law. This comparison includes expenditure budget overruns. Expenditure budget overruns were as follows:

Year ended September 30, 2004	Original Budget	Final Budget	Actual	Fi	riance with nal Budget Positive Vegative)
Adults with mental illness	\$ 19,205,973	\$19,796,456	\$19,910,435	\$	(113,979)
Children with emotional disturbance	\$ 6,671,290	\$ 6,325,472	\$ 6,338,798	\$	(13,326)
Substance abuse	\$ 2,779,170	\$ 2,804,197	\$ 2,852,984	\$	(48,787)

Deficit Net Assets – At year-end, the Compensated Absences Reserve Internal Service Fund had a deficit in its net assets of \$382,335. This balance represents the unfunded (long-term) portion of compensated absences payable that has not yet been charged to the General fund or the MDCH contract. The Authority plans to eliminate this deficit through charges to the General Fund in future periods.

Notes to Financial Statements (Continued)

4. Deposits and Investments

Deposits – At year-end, the carrying amount of the Authority's deposits was \$6,390,539. The bank balance of the deposits was \$6,932,996 of which \$101,187 was insured by the Federal Depository Insurance Corporation (FDIC), and the balance of \$6,831,809 was uninsured and uncollateralized. The Authority believes that, due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Authority evaluates each financial institution it deposits funds with and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Investments – The Authority is authorized by Michigan Public Act 20 of 1943 (as amended) to invest surplus funds in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, banker's acceptances, and mutual funds and investment pools that are composed of authorized investment vehicles. The Authority has the ability and intent to hold these investments to maturity.

The Authority's investments during the year consisted of money market and mutual funds. There was \$5,808,256 invested in such funds at September 30, 2004.

For the purpose of providing an indication of the assumed levels of risk, investments are categorized as follows:

Category 1 – Investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name.

Category 2 - Uninsured or unregistered investments for which the securities are held by counterparty's trust department or agent in the Authority's name.

Category 3 – Uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in the Authority's name.

Notes to Financial Statements (Continued)

At year-end, the Authority's investment balances were all uncategorized as to risk. A reconciliation of cash and investments as shown on the Combined Balance Sheet follows:

Year ended September 30,	2004
Statement of Net Assets:	
Cash and cash equivalents	\$ 6,018,921
Investments	5,791,374
	11,810,295
Statement of Fiduciary Net Assets:	
Cash and cash equivalents	381,133
Investments	 16,882
	398,015
`	\$ 12,208,310
Bank deposits (checking accounts, savings accounts, and certificates of deposits)	\$ 6,390,539
Investments in mutual funds	5,808,256
Cash on hand	 9,515
	\$ 12,208,310

5. Receivables

Receivables, as of September 30, 2004, for the Authority's General and Internal Service Funds in the aggregate, are as follows:

	General	Internal Service	Total	Amount Not Expected to be Collected Within One Year
Receivables:				
Grants and contracts	\$ 1,878,165	\$ -	\$ 1,878,165	\$ 821,098
Affiliate	1,980,988	-	1,980,988	, <u>-</u>
Patient fees	847,604	-	847,604	-
Trade	101,636	-	101,636	
Other receivable	472,700	440	473,140	-
Total Receivables	\$ 5,281,093	\$ 440	\$ 5,281,533	\$ 821,098

Notes to Financial Statements (Continued)

Governmental Funds report deferred revenue in connection with receivables for revenue that are not considered to be available to liquidate liabilities of the current period. Governmental Funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue and unearned revenue reported in the Governmental Funds were as follows:

	 Unearned
General Fund	\$ 4,213,747

6. Capital Assets

Capital asset activity for the year ended September 30, 2004, was as follows:

		Balance					Balance
	0	ctober 1, 2003	Additions	Dedi	ections	Se	ptember 30, 2004
Governmental Activities:							
Capital assets not depreciated - Land	\$	1,328,250	\$ 100,000	\$	-	\$	1,428,250
Capital assets depreciated:							
Building and improvements		10,944,770	295,000		-		11,239,770
Capitalized building lease		10,215,407	-		-		10,215,407
Equipment		2,977,627	34,133		-		3,011,760
Vehicles		2,345,293	284,137		-		2,629,430
Totals at Historical Cost		27,811,347	713,270		-	-	28,524,617
Less accumulated depreciation:							
Building and improvements		(5,157,195)	(451,019)		_		(5,608,214)
Capitalized building lease		(1,645,147)	(243,946)		-		(1,889,093)
Equipment		(2,366,230)	(152,959)		-		(2,519,189)
Vehicles		(2,071,320)	(220,437)		-		(2,291,757)
Total accumulated depreciation		(11,239,892)	(1,068,361)		-		(12,308,253)
Total capital assets being depreciated, net		15,243,205	(455,091)		_		14,788,114
Net Capital Assets	\$	16,571,455	\$ (355,091)	\$	_	\$	16,216,364
Depreciation Expense by Function							
Adults with mental illness	\$	338,927					
Children with emotional disturbance		43,764					
Developmental disabilities		469,114					
Substance abuse		36,577					
Board administration		179,979					
Total Depreciation Expense by Function	\$	1,068,361					

Notes to Financial Statements (Continued)

The Authority leases various buildings and equipment under operating leases. These leases generally have a term of one year. Total costs for such leases were recorded as rent expense in the supplemental financial schedules included with this report and amounted to \$557,930 for the year ended September 30, 2004.

7. Long-Term Obligations

The following is a summary of long-term debt transactions of the Authority:

September 30, 2004	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Governmental Activities:					
Installment debt:					
Capital leases	\$ 6,489,823	\$ -	\$ 399,366	\$ 6,090,457	\$ 423,248
Land contracts	984,571	395,000	135,007	1,244,564	134,725
Notes payable	2,657,155	-	170,462	2,486,693	218,891
Vehicle loans	334,095	284,137	228,270	389,962	187,758
Total installment debt	10,465,644	679,137	933,105	10,211,676	964,622
Estimated insurance liability	82,430	-	82,430	-	-
Compensated absences	1,724,987	1,892,116	1,886,143	1,730,960	1,348,625
Total Long-Term Liabilities -					
Governmental Activities	\$12,273,061	\$2,571,253	\$2,901,678	\$ 11,942,636	\$ 2,313,247

Annual requirements to pay principal and interest on long-term debt are as follows:

Governmental Activities				
iber 30, Principal Inter		Total		
\$ 964,622	\$ 424,939	\$ 1,389,561		
905,513	385,227	1,290,740		
891,874	344,030	1,235,904		
642,188	306,638	948,826		
499,122	282,558	781,680		
2,824,149	1,074,957	3,899,106		
2,956,015	396,543	3,352,558		
520,062	23,560	543,622		
8,131	132	8,263		
\$10,211,676	\$ 3,238,584	\$13,450,260		
	\$ 964,622 905,513 891,874 642,188 499,122 2,824,149 2,956,015 520,062 8,131	Principal Interest \$ 964,622 \$ 424,939 905,513 385,227 891,874 344,030 642,188 306,638 499,122 282,558 2,824,149 1,074,957 2,956,015 396,543 520,062 23,560 8,131 132		

Notes to Financial Statements (Continued)

Long-term installment debt payable at September 30, 2004, is comprised of the following:	
Capital building lease payable, interest ranging from 4.30% to 5.00%, due in semi-annual installments ranging from \$215,553 to \$488,335, plus interest, though July 2018; the lease continues through July 2048	\$ 5,206,959
Capital building lease payable, interest at 7.39%, due in monthly installments of \$14,670 through July 2008; the lease continues through July 2038 with payments consisting solely of utility costs after July 2008	574,876
Capital leasehold improvements payable, interest at 5.00%, due in monthly installments of \$2,285 through April 2021	308,622
Land contract and notes payable, including interest ranging generally from 85% of prime (prime was 4.75% at September 30, 2004), to 8.50%, due in monthly installments through September 2024, collateralized by land and buildings	3,731,257
Vehicle leases payable, interest ranging from 2.72% to 4.73%, due in monthly installments ranging from \$10,750 to \$11,939 through July 2005	389,962
Total Long-Term Debt	\$ 10,211,676

8. Risk Reserve Funds

Net assets in the Mental Health and Substance Abuse Risk Reserve Internal Service Funds are restricted for future shortfalls between revenue and expenditures. Management has developed, as approved by the Authority's Board, a budget goal to reach an amount sufficient to cover the estimated potential risk exposure of \$6,562,157 (\$5,405,905 Medicaid, \$1,076,814 State General Fund, and \$79,438 local) in the Mental Health Risk Reserve. The Authority is currently contracting with an actuarial firm to estimate the potential risk of the affiliation.

The Fixed Asset Replacement and Compensated Absences Reserve Internal Service Funds are restricted for securing resources to fund future capital asset replacements and making payments on accrued compensated absences, as permitted by the Michigan Mental Health Code.

Notes to Financial Statements (Continued)

Following is a schedule of changes in Net Assets of the Risk Reserve Internal Service Funds:

Year ended September 30, 2004	Mental Health	Substance Abuse	Fixed Asset Replacement	Compensated Absences
Beginning balance Prior period adjustment (Note 12)	\$ 2,029,709	\$ 49,124 -	\$ 5,728,637 377,175	\$ (388,308)
Beginning balance, as restated	2,029,709	49,124	6,105,812	(388,308)
Additions Deletions	279,934 -	37,060 (64)	1,522,664 (1,580,132)	6,123 (150)
Ending balance	\$ 2,309,643	\$ 86,120	\$ 6,048,344	\$ (382,335)

Additions to the Mental Health and Substance Abuse Risk Reserves were comprised of funds received from the General Fund and interest earnings. Additions to the Fixed Asset Replacement and Compensated Absences Reserves were comprised of interfund charges for services and gains on the sale of capital assets. Reductions in the reserves represented the funds' respective program services and depreciation.

Contributions to the Internal Service Funds are considered eligible expenditures under the MDCH contract and, accordingly, are included on the Statement of Revenue, Expenditures, and Changes in Fund Balance – General Fund in the various expenditure categories.

9. Interfund Receivables and Payables

The Authority has the following interfund receivables and payables:

Year ended September 30, 2004		terfund eivables	Interfund Payables			
General Fund	\$	-	\$	331,493		
Mental Health Risk Reserve		256,115		_		
Substance Abuse Reserve		31,722		-		
Fixed Asset Replacement Reserve		43,656				
Total	\$	331,493	\$	331,493		

These balances represent the difference between the cumulative cash flows of the fixed asset replacement reserve and the amounts charged to the General fund as eligible expenditures under the MDCH contract. This liability will be repaid through future charges for services for fixed asset usage.

Notes to Financial Statements (Continued)

10. Retirement Plan

The Authority participates in an agent multiple-employer defined benefit pension plan administered by the Municipal Employees Retirement System of Michigan (MERS), which provides retirement, death, and disability benefits covering substantially all of the Authority's full-time employees. MERS issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to MERS, 447 North Canal, Lansing, Michigan 48917.

The obligation to contribute to and maintain MERS for these employees was established by negotiation with the Authority's competitive bargaining units and requires a contribution from employees of 3% to 5%.

For the year ended September 30, 2004, the Authority's annual pension cost of \$2,463,012 for the plan was equal to the required and actual contribution. The annual required contribution was determined as part of an actuarial valuation as of December 31, 2003, using the entry actual age cost method. Significant actuarial assumptions used include (1) an 8% investment rate of return and (b) projected salary increases of 4.5% per year, plus a percentage based on an age related scale to reflect merit, longevity, and promotional salary increases. Both (a) and (b) include an inflation adjustment of 4.5%. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The amortization period at December 31, 2003, the date of the latest actuarial valuation is 10 years.

Three-Year Trend Information

	Year ended September 30,					
	2004	2003	2002			
Annual pension cost	\$ 2,463,012	\$ 1,806,966	\$ 1,719,789			
Percentage of APC contributed	100%	100%	100%			
Net pension obligation	-	-	_			
Actuarial value of assets	54,621,704	48,607,937	45,357,586			
Actuarial accrued liability (entry age)	74,479,549	64,395,940	59,217,353			
Unfunded AAL	19,857,845	15,788,003	13,859,767			
Funded ratio	73%	76%	77%			
Covered payroll	21,490,994	24,840,543	26,397,374			
UAAL as a percentage of covered payroll	92%	63%	52%			

Notes to Financial Statements (Concluded)

11. Grants and Contracts

The Authority participates in various federal, state, and local grants for mental health and substance abuse programs. Certain provisions and allowable levels of participation and expenditures not qualifying for participation are subject to interpretation and adjustment by appropriate governmental agencies. The state of Michigan allocation under Act 258 provides support for all qualifying programs and allowable costs, with the balance being provided by contributions from local sources.

State grants are subject to audit by responsible state agencies. Although these audits may result in some changes, they are not expected to have a material effect on the financial statements.

12. Prior Period Adjustment

In the financial statements for the year ended September 30, 2003, an error was made in accounting for an internal receivable and payable in the General Fund and Fixed Asset Reserve Internal Service Fund, respectively. This error has been corrected and has had the following effect on the beginning fund balances:

	General Fund	Fixed Asset Reserve Fund	Internal Service Funds
Fund Balance/Net Assets, at September 30, 2003 as previously reported	, \$ 2,017,862	\$ 5,728,637	\$ 7,419,162
Prior period adjustment	(377,175)	377,175	377,175
Fund Balance/Net Assets, at September 30, 2003 as restated	, \$ 1,640,687	\$ 6,105,812	\$ 7,796,337

Combining and Individual Fund Statements and Schedules

	Adults With	Children With	
Year ended September 30, 2004	Mental Iliness	Emotional Disturbance	Developmental Disabilities
Expenditures:			
Current:			
Salaries and wages	\$ 8,527,327	\$ 3,652,220	\$ 9,701,164
Fringe benefits	2,148,889	959,817	2,560,671
Contractual services:	, , ,	, , , , , , , , , , , , , , , , , , , ,	2,500,071
Clinical	100,096	15,102	53,512
Client	3,657,547	477,072	15,004,346
Inpatient	2,340,265	273,976	,,
Other	185,841	98,628	132,125
Communication	104,623	49,620	93,282
Dues and supplies	461,956	67,387	407,441
General insurance	302,747	100,156	279,465
Client transportation	183,636	84	831,763
Travel, conferences, and parking	66,199	146,376	172,268
Employee programs	3,044	1,701	2,684
Utilities	189,726	50,213	165,420
Rent	117,220	23,141	381,277
Repairs and maintenance	234,930	40,156	319,145
Program food services	158,664	-	74,999
Local match	447,052	242,222	727,725
Loss Reserve Provision	87,019	27,444	141,652
Other	1,615	581	29,509
Fixed asset use allowance	592,039	112,902	462,151
Total Expenditures before Medicaid Pass-Through	© 10.010.425	\$ 6,338,798	\$ 31,540,599

Total Expenditures

Schedule of Functional Expenditures General Fund

			Board	Substance
Total	Affiliation		Administration	Abuse
\$ 27,464,02	351,662	\$	\$ 3,409,806	\$ 1,821,842
7,222,81	91,750		950,283	511,407
173,12	-		_	4,417
19,138,96	-		-	, <u>-</u>
2,614,24	-		-	-
690,72	57,314		158,734	58,087
378,87	874		98,058	32,414
1,337,84	6,426		314,974	79,660
841,72	8,338		97,095	53,920
1,068,84	-		52,235	1,122
459,45	4,863		49,113	20,636
49,59	31		41,335	795
514,61	1,573		54,674	53,008
557,93	351		14,886	21,055
882,86	1,291		262,216	25,123
303,79	· <u>-</u>		-	70,127
1,550,40	-		133,405	-
287,83	•		-	31,722
120,71	7,334		81,440	235
1,522,66	3,631		284,527	67,414
67,181,03	535,438	\$	\$ 6,002,781	\$ 2,852,984
31,630,52				
\$ 98,811,55				

Combining Statement of Net Assets Internal Service Funds

September 30, 2004	Mental Health Reserve	ubstance Abuse Risk Reserve	,	Fixed Asset Replacement Reserve		ompensated Absences Reserve		Total
Assets:								
Cash and cash equivalents	\$ 369,952	\$ 54,398	\$	_	\$	1,348,625	s	1,772,975
Investments	1,683,136		-	-	•	-	4	1,683,136
Internal balances	256,115	31,722		43,656		_		331,493
Interest receivable	440			_		-		440
Capital assets not depreciated	-	-		1,428,250		_		1,428,250
Capital assets depreciated, net	-	_		14,788,114				14,788,114
Total Assets	\$ 2,309,643	\$ 86,120	\$	16,260,020	\$	1,348,625	\$	20,004,408
Liabilities: Current portion of long term liabilities Long-term liabilities: Compensated absences Debt and capital lease obligations	\$ - - -	\$ - -	\$	964,622	\$	1,348,625 382,335	\$	2,313,247 382,335 9,247,054
Total Liabilities	 -	-		10,211,676		1,730,960		11,942,636
Net Assets: Investment in capital assets, net of related debt	-	<u>-</u>		6,048,344		-		6,048,344
Unrestricted	 2,309,643	 86,120		-		(382,335)		2,013,428
Total Net Assets	 2,309,643	86,120		6,048,344		(382,335)		8,061,772
Total Liabilities and Net Assets	\$ 2,309,643	\$ 86,120	\$	16,260,020	\$	1,348,625	\$	20,004,408

Combining Statement of Revenue, Expenses and Changes in Net Assets Internal Service Funds

Year ended September 30, 2004	Mental Health Reserve	Substance Abuse Risk Reserve	R	Fixed Asset eplacement Reserve	ompensated Absences Reserve		Total
Operating Revenue -							
Charges for services	\$ 256,451	\$ 37,026	\$	1,522,664	\$ 6,123	_\$	1,822,264
Operating Expenses:							
Program services	-	64		-	150		214
Depreciation	 	-		1,068,361			1,068,361
Total Operating Expenses	 	64		1,068,361	150		1,068,575
Operating Income	256,451	36,962		454,303	 5,973		753,689
Non-Operating Revenue (Expense):							
Interest income	23,483	34		_	_		23,517
Interest expense	 -	-		(511,771)	 		(511,771)
Total Non-operating Revenue (Expense)	23,483	34		(511,771)	 		(488,254)
Net Income (Loss)	279,934	36,996		(57,468)	5,973		265,435
Net Assets (Deficit), beginning							
of year, as restated (Note 12)	2,029,709	49,124		6,105,812	(388,308)		7,796,337
Net Assets (Deficit), end of year	\$ 2,309,643	\$ 86,120	\$	6,048,344	\$ (382,335)	\$	8,061,772

Combining Statement of Cash Flows Internal Service Funds

Year ended September 30, 2004	Mental Health Reserve	Substance Abuse Risk Reserve	Fixed Asset Replacement Reserve	Compensated Absences Reserve	Total
Operating Activities: Payments received from other funds Payments to outside parties	\$ 329,436 -	\$ 5,304 (30,015)	\$ 1,479,008 -	\$ 6,123	\$ 1,819,871 (30,015)
Cash Provided by (Used in) Operating Activities	329,436	(24,711)	1,479,008	6,123	1,789,856
Capital and Related Financing Activities: Proceeds from new installment debt Principal payments Interest payments Capital asset purchases	- - - -	- - -	679,137 (933,105) (511,771) (713,269)	- - -	679,137 (933,105) (511,771) (713,269)
Cash Provided by (Used in) Financing Activities	-	•	(1,479,008)		(1,479,008)
Investing Activities: Interest received Purchase of investment	23,344 (348,710)	78	-	-	23,422 (348,710)
Cash Provided by (Used in) Investing Activities	(325,366)	78	_	-	(325,288)
Increase (Decrease) in Cash and Cash Equivalents	4,070	(24,633)	-	6,123	(14,440)
Cash and Cash Equivalents, beginning of year	365,882	79,031		1,342,502	1,787,415
Cash and Cash Equivalents, end of year	\$ 369,952	\$ 54,398	\$ -	\$1,348,625	\$ 1,772,975
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities: Operating income Adjustments to reconcile operating income to net cash provided by (used in) operating activities:	\$ 256,451	\$ 36,962	\$ 454,303	\$ 5,973	\$ 753,689
Depreciation Change in a second state of the second	-	-	1,068,361	-	1,068,361
Changes in assets and liabilities: Internal Balances Accounts payable - other Compensated absences payable	72,985	(31,722) (29,951)	(43,656)	- - 150	(2,393) (29,951) 150
Cash Provided by (Used in) Operating Activities	\$ 329,436	\$ (24,711)	\$ 1,479,008	\$ 6,123	\$ 1,789,856

Statement of Changes in Assets and Liabilities Agency Fund

Year ended September 30, 2004	Beginning Balance	Additions	Deletions	Ending Balance
Assets -				
Cash and cash equivalents	\$ 432,552	\$ 4,997,697	\$ 5,048,916	\$ 381,333
Liabilities -				
Accounts payable	\$ 432,552	\$ 4,997,697	\$ 5,048,916	\$ 381,333



BDO Seidman, LLPAccountants and Consultants

211 East Water Street, Suite 300 Kalamazoo, Michigan 49007 Telephone: (269) 382-0170 Fax: (269) 345-1666

March 2, 2005

Community Mental Health Authority of Clinton, Eaton, and Ingham Counties 812 East Jolly Road, Suite 210 Lansing, Michigan 48910

Dear Members of the Board, Executive Director, and Finance Director:

Professional standards require us to advise you of the following matters relating to our recently completed audit. The matters discussed herein are those that we have noted as of December 23, 2004, and we have not updated our procedures regarding these matters since that date to the current date.

Our Responsibility Under Generally Accepted Auditing Standards

As stated in our engagement letter dated October 11, 2004, our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatements, whether caused by error or fraud. An audit in accordance with generally accepted auditing standards does not provide absolute assurance or a guarantee of the accuracy of the financial statements and is subject to the inherent risk that errors or fraud, if they exist, have not been detected. Such standards also require that we obtain a sufficient understanding of Community Mental Health Authority of Clinton, Eaton, and Ingham Counties' (the Authority) internal control to plan the audit. However, such understanding is required for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Authority are described in the notes to the financial statements. We noted no transactions entered into by the Authority during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based upon management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. Our audit procedures included inquiries about, and a review of, significant management judgments and accounting estimates.

Significant Audit Adjustments

For purposes of this letter, professional standards define a significant audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. The definition includes adjustments that were not recorded by the Authority because they are not material to the current financial statements but might be potentially material to future financial statements. We made a few adjustments during the audit, which related to the prior period adjustment in accounting for an internal receivable and payable in the General Fund and Fixed Asset Reserve Internal Service Fund.



BDO Seidman, LLP Accountants and Consultants

Community Mental Health Authority of Clinton, Eaton, and Ingham Counties March 2, 2005 Page Two

Disagreements With Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the Authority's financial statements or the audit report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultation With Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principal to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed With Management Prior to Recurring Retention

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Authority's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered some delays in performing the audit due to the adjustments required during the audit relating to the year-end close out with MDCH. In all other respects, we had no difficulty in performing the audit.

Independence

Generally accepted government auditing standards require BDO Seidman, LLP, to be independent both in fact and appearance. We are not aware of any relationships between BDO Seidman and the Authority that, in our professional judgment, may reasonably be thought to bear on our independence. We confirm that as of December 23, 2004, and throughout the 2004 audit, we were independent accountants with respect to the Authority in accordance with the requirements of the standards.

Should you desire further information concerning these matters, Larry Oberst or Kristy Daniel will be happy to meet with you at your convenience.

This letter is solely for the internal use of the board and management of Community Mental Health Authority of Clinton, Eaton, and Ingham Counties and should not be distributed to any other persons or used for any other purpose.

Very truly yours,

BDO SEIDMAN, LLP

Certified Public Accountants

BDO Seidran, LLA